THE DECLINE OF AUSTRALIA’S RESOURCES ECONOMY

Comments from Addresses by

H.M. Morgan, President, Australian Mining Industry Council, to the National Press Club, October 7, 1982.

A.C. Copeman, Chief Executive, Peko-Wallsend Limited, to S.I.A. New South Wales Division, October 12, 1982.


EDITORIAL NOTE: The comments presented are taken from the above addresses, attended with interest by some of JASSA’s readers. A common line of concern for the future, and the necessity for responsibility to be taken by the investment community emerges in the complete text of all the papers, from which sections only are extracted below. The importance of resources to economic growth is reflected in the fact that seven out of the ten largest listed Australian companies are substantially involved in mining and petroleum.

HUGH MORGAN, WESTERN MINING CORPORATION HOLDINGS LIMITED

The title of Mr. Morgan’s address was “Federalism and the Mining Industry”. Mr. Morgan is also Executive Director, Western Mining Corporation Holdings Limited and has also recently been appointed one of the directors of the governing council of the Australian Associated Stock Exchanges. Mr. Morgan has a significant indirect responsibility for Australia’s economic policies, in his role as a member of the Board of the Reserve Bank of Australia. After his introductory remarks, Mr. Morgan said:

“Australia is fundamentally well placed to weather economic storms. We are, potentially, a very wealthy country. Indeed, a sub-title to this paper could well be “Why isn’t Australia the richest country in the world?”

But potential wealth is a very different thing from actual economic performance, as the economic history of Argentina makes abundantly clear.

If Australia can grasp the reality of our present situation, and adjust to this reality, then we will ride the storm. Failure to perceive the reality, unwillingness to make adjustments, will lead to accelerating economic decline.

World steel consumption is a crucial indicator of economic confidence. It is a major component of both capital investment and general consumer demand. We now find that world steel production is heading towards half of what it was in 1974, and the U.S. steel industry is operating at about 40 per cent of capacity. This compares with an Australian figure of about 70 per cent.

In the world economy, where Australia’s mining industry must compete in a fiercely competitive and unprotected market, we find that demand is contracting to an alarming degree. The industry is being pushed to the very threshold of its capacity to survive.

Internationally we see the economic order established at Bretton Woods breaking down. Some $200 billion of loans to countries in the Middle East, Latin America and elsewhere are presently subject to “rescheduling negotiations” — to express this problem at its kindest. The world banking system is under great pressure. Protectionism is looming up again as a major problem, as it did in the twenties.

Apparently restricted to the short-term view, government after government seems unable to resist the temptation to attempt to insulate vulnerable domestic industries against recession and foreign competition.

These two elements, the dangers to the international banking system, and the rising tide of protectionism, are danger signals which Australians should not ignore.

In my view, however, the most significant indicator of our plight is the relative decline in Australian per capita real income compared with the rest of the world. If we take the long term view, then prior to Federation, the citizens of the six Australian colonies were, per capita, the wealthiest people in the world.

 Australians in the 1890’s and early 1900’s were better housed, better clothed, better fed and entertained themselves better than anyone else in the world.
This wealth was based on the pastoral and agricultural industries, and on the mining industry, particularly in base metals, lead, copper, zinc, tin, and in the precious metals, silver and gold.

Since World War I, relatively, Australians have been sliding steadily backwards, and in the last thirty years, our performance has been very poor. This is particularly so for a country which has attributes and assets which most other countries envy.

We are now about seventeenth in world ranking. Japan has overtaken us, and if current rates persist, Singapore will overtake us in 1991.

The Argentine, at the beginning of this century was, like Australia, a wealthy country. Today it is a very poor country, with political and social consequences that are now familiar to us. If Australia persists on the same road that has taken us from 1st to 17th in 70 years, then our future is the Argentine experience.

The question arises, why should the mining industry have a particular concern about Australia’s institutional structure. The mining industry survived the last depression better than many industries. Why should it not survive another one, if that should be what is in store for us?

The answer is twofold. First is the industry’s political vulnerability. No other industry depends so much on the frequent exercise of ministerial discretion for its day to day survival.

The second and perhaps main, factor in our poor profitability, and declining survival capacity, is the size of the Government “take”. Industry surveys show State and Federal Governments in 1980/81 between them took approximately 60 per cent of operating surplus and up to 78 per cent of operating surpluses in the coal industry. The extent of this “take” is something the industry cannot continue to live with, and that is something our political leaders will have to understand if they still want to have a mining industry in the coming decades.

The domestic factors of political vulnerability and the extent of the Government “take” are exacerbated by our present Federal structure. We have competing centres of sovereignty in Australia, a situation which requires sophisticated political management if our economy is going to remain competitive. This differentiated sovereignty is a cause of great irritation to politicians. In Canberra it is seen as imposing limits to centralist power and direction, and in the States the level of irritation of Federal intervention is sufficient to maintain secessionist sentiment in at least two States.

On January 28, 1966, the first drill intersection with the Western Mining nickel orebody at Kambalda took place. Less than eighteen months later, in June 1967, the first shipment of nickel concentrates left the treatment plant. During this period, Western Mining had to negotiate with two government departments. Just two. This has given us a new idea of what heaven is like.

Despite this speed; despite the fact that only two government departments were involved; Kambalda is an environmentalist’s and a town planner’s delight. The company was able to move quickly and get a market share at a time of buoyant prices. Contrast that with the situation now faced at Roxby Downs.

The orebody at Olympic Dam, was discovered in 1975. If Western Mining can achieve a first ore shipment by 1988, thirteen years after discovery, it will be regarded as a considerable feat. WMC, as manager of the joint venture, is presently dealing with sixteen different government departments and is coming up to its third government enquiry, all in the process of doing a feasibility study. The E.I.S., for Olympic Dam, released yesterday, took 18 months to prepare and cost 1.5 million dollars.

This comment is not meant to denigrate South Australia’s enthusiastic co-operation and support for the project, but it does exemplify the way of life throughout Australia for new mineral developments.

The competition between the States and the Commonwealth, for money, for power, for applause, is consequently one of the main factors behind the declining profitability and the diminishing survival capacity of the mining industry.”

Mr. Morgan went on to develop a case for change in the approach to Federal and State economic responsibilities.

“My argument is, that,

First; whatever we are doing now is a disaster for the industry.

Second; the options and we have no partisan brief either way, are either, as Bob Hawke proposed, to centralise power in Canberra at the expense of the States; or to have the Commonwealth Government “back-off” and recreate a more accountable and responsible State role.

Third; from my viewpoint, the Australian community does not respect the centralist role of Canberra sufficiently to make the centralist option a viable one, and therefore, it is the second alternative upon which attention must be concentrated.

There are other federal systems of course. And they are going through similar problems.
As we have observed, the State — Federal war, so dramatically evidenced in Canada during the last ten years, fought over the fast dying body of its mining industry, is progressively becoming evident in Australia.

It is vital for our survival as an industry, and, I suggest, for Australia, that a “truce” be declared now before irreparable harm is done.

The politics of this country have become debilitated by quarrels about cutting up the national cake, by disputes over who is going to supervise and regulate the baking of the cake, by arguments over sales tax on the cake, and income tax on the bakers.

Indeed, the production of the cake is so far, it seems, from the minds of our political leaders, that in the case of the much trumpeted mining boom, it was a phantom cake that the electorate was encouraged to plunge its knife into.

The reforms I have been advocating will above everything else, encourage a return to consideration of the politics of productions, rather than obsession with the politics of consumption.

These proposals may seem to you, here in Canberra, to be extreme. Let me suggest that in 12 months time, there are going to be many very authoritarian proposals for dealing with, what will be called, the inability of our democratic system to handle the economic problems that will beset us. The very fabric of the Federation will be under great strain.”

CHARLES COPEMAN, PEKO-WALLSEND.

Mr. Copeman referred to the remarks which had been made some days previously by Hugh Morgan, and went on to say:

“Let me add to that recitation — the Japanese steel industry is now operating at less than 60 per cent of capacity. Furthermore the L.M.E. price for aluminium is two-thirds of the producer price. It has been said, responsibly, that aluminium will be in surplus till at least 1988 even if there were an upturn starting now. This will be so, even though the Japanese are in the process of reducing their aluminium metal output to 10 per cent of that two years ago. The NUEXCO price for uranium is less than half the average western world contract price. Some of you will be aware that some foreign coals are being delivered into overseas markets at lower prices than the f.o.b. prices of comparable Australian coals. That is, the sea freight component of price as been eroded away.”

Mr. Copeman also made reference to the illusion of enduring prosperity, in the face of persistent economic decline in Australia’s relative world position.

“It has been taken for granted in this country, based largely on the memory of that former position of superiority, that we have achieved an everlasting double first — in democracy and in prosperity.

Profitability

Today we are concerned with recapturing the prosperity — which some of us also happen to believe is essential to the democracy — and it is the prosperity of industry, especially the mining industry, that I am talking about.

In doing so I am not making a special plea for Peko, or for the mining industry, but for a proper concern in the nation for the level of return on investment.

Return on investment has been neglected by everyone — including the securities industry — to the point where at times it seems as if one is introducing a new concept by even talking about it — and it is certainly a concept which the media steadfastly refuses to bring out into public debate.

Your profession has developed to look after “securities” — and yet we all know full well how insecure are those pieces of paper in which you deal. You analyse the performance of the investments — but how few of them ever measure up to the criteria for investment that we earnestly set ourselves for new projects before commitment to them. Many of you will be familiar with the few calculations that have been made, in real terms and over a prolonged period, of the yield of leading stocks in the mining industry. The results, including capital appreciation, are appallingly low. How often have we said of an investment in productive fixed assets — the owner would be better off to sell out and put his money on deposit! — and this was being said long before the recent rise in interest rates.

Clearly there are limits to such sales, as the buyers of the assets inherit the same problems of achieving a proper return, and we cannot all sell out of fixed assets! As individuals we can opt out, but as a nation we cannot — and that is where our underlying problem has been obscured.

It is my submission to you that we have become increasingly a nation of traders, and not of investors in assets. We have lost sight of the need for a proper return on investment.

I put it to you that there has been a steady deterioration in the return on investment relative to the cost of money, which is illustrated in part by the figure quoted from Hugh Morgan’s paper. Another way of showing the deterioration is to look at the increase in the share of the non-farm gross domestic product going to wages and salaries compared to that going to profits. Just in the last 10 years this wages share has increased
from 63 per cent to 68 per cent, while profits have slid from 17 per cent to 13 per cent. What is important in this comparison is that the capital assets of companies have increased very greatly in real terms, with increasingly capital intensive methods being applied, and yet the proportion of GDP represented by company income has fallen. In these rather gross terms it is evident that the return on investment has been falling while the cost of money has been rising.

I suspect, but am not yet in a position to demonstrate, that this fall has been taking place over a very long period — perhaps as much as sixty years. At the same time, as the share of wages and salaries has increased, savings have acquired a different character, less risk-taking in nature.

While these processes have been taking place, we have turned attention to other relatively unproductive stores of value — increasingly to real estate, art, tax schemes, cash management trusts — showing our disillusionment with the ownership of equity in public companies. We have also talked increasingly about the growth of the service sector of the economy, as if that growth was some sort of substitute for the fundamentals of our basic industries to provide growth. We also talk about the “post-industrial society” as if those countries still deeply engaged in the industrial society — Japan, Korea, ASEAN — owe us something for becoming “post-industrial” and thereby becoming less competitive. Sir Douglas Copland 40 years ago talked about the trend in Australia towards “the milk-bar economy” — he was more prophetic and accurate than many would have understood at the time.

What do we do about this?

Firstly — in the Western World we have evolved over some 200 years the best method of pooling resources to create enterprises — the company. Whatever political and economic ideologies have developed since, the company, for all the faults of people, remains the most effective free enterprise means of generating wealth on a large scale. We have neglected it — both practically and philosophically. We have a major task to undertake to rebuild the profit basis and to regain public acceptance.

Wages and Policy

Much of my time is spent in the field of industrial relations — trying to persuade employers not to give wage increases which their firms can’t afford, and trying to understand why union leaders will not respond to reason. The cynics say that both tasks are impossible — why bother? I’ll give you a few reasons — first of all, the wage structure of this country has been dictated for many years by people who have little idea of the fundamentals of business — many of them have an ideological bias against business and free enterprise. This may not be news to you, but how many of you have come close to the people involved, the abstract and theoretical ideals that fill their minds, and the powerful subversive influences at work on them. Even employers organisations put out lengthy papers about wage-fixing which manage to avoid entirely the concepts of “profit” and “return on investment”. Bland statements by employers such as “wage increases should not exceed productivity increases” are so question-begging, and yet are still being written, even today.

It is no exaggeration to say that the triumvirate of Arbitration Commissions, Employers Organisations and Trade Unions has been proceeding on one wages game plan, while the managers of businesses and industries have been trying to keep going a completely separate and very basic game of profits and jobs. Only the deepening recession and high interest rates have brought any realisation that the two are connected in any way. Let me assure you again that this is no exaggeration.

There is a job to be done, and the Securities Institute is vital to that job if the word “security” is to regain its proper meaning. In concluding, let me ask you how you would deal with the following real situations — cynicism apart — the trade union leader who ask where has B.H.P. hidden the extra cash it has got from its Fixed Asset Utilisation Charge — the head of a State Treasury who tells the chairman of a public company that he has shown a loss by employing a sharp accountant — the State Cabinet Minister who says that his colleagues don’t believe balance sheets — the Arbitration Commissioner who says the same — the trade union leaders who say that if a wage increase will close you down, then you should close down — the trade union leader who says that the wage increase is necessary so that on closure the retrenchment pay will thereby be higher — the trade union leader who says that he is not interested in our statements about poor return on investment when he sees daily in the papers the fortunes being made by the takeover kings, or the tax avoidance figures, or the windfall interest rates, or the statements that a company has sold coal on long-term contracts valued at “x” billion dollars, or has found an ore body which contains metal to a value of “y” billion dollars in the ground. And now how do we explain that the Dow Jones has exceeded 1,000?

Our guests from overseas may be somewhat surprised at this public examination of the climate of investment in Australia. However, the recession is bringing into sharper focus a process which has been creeping insidiously across the Western World — a process
which can and must be reversed if democracy is to survive.

Finally, to encourage you in the task, let me quote from Lord Keynes: “The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Madmen in authority are distilling their frenzy from some academic scribbler of a few years back”.

**MAX ROBERTS, RENISON GOLDFIELDS CONSOLIDATED**

In his Melbourne address, Mr. Roberts referred to some encouragement for recovery, from preliminary international signals. He said that “There are a number of important ongoing conditions, which point strongly to the forthcoming recovery of output being muted, and which are symptomatic of some unresolved fundamental problems which will retard average real world growth for some years to come yet.

Firstly, the now vast structure of international and domestic debt remains over-extended. Much of this debt is already in default, at least in reality if not officially, and the borrowers concerned — including many western corporations, less developed countries, and some Comecon countries — will now have to restrain their spending accordingly.

Secondly, despite falls in interest rates, real interest rates remain fairly high, partly because of creditors’ worries about the stability of the world financial system. The low or negative real interest rates which prevailed during the 1970’s when creditors had not really woken up to the realities of sustained high inflation rates, are most unlikely to return.

Thirdly, while inflation rates have receded they have far from disappeared, and any resumption of world economic growth will tend to stabilise prevailing inflation rates, if not increase them.

Fourthly, government spending, and regulation, remains high in most western economies, despite years of ostensible conservative government in some of these countries. As an economist said recently: “The private sector is controlled by the government, but the public sector is controlled by nobody”. In addition the increasing problems of unemployment are inclining governments more and more towards protectionist policies for some important trading industries, such as steel and chemicals.

In summary, these factors will together retard the anticipated recovery of world economic output. This recovery will probably begin in the United States and be followed elsewhere in late 1983. Very recent production figures from the United States suggest however that the recovery has not really begun yet.”

After making comment about tin (low prices remaining for necessary production cutbacks to be sustained), copper (cyclical price recovery possibly imminent), gold (modest mid-term price recovery continuing) and coal (sound opportunities for competitive suppliers, without dramatic long term real price increases), Mr. Roberts spoke about the Australian domestic environment for the mining industry.

“The mining industry is subject to a number of important additional government financial impositions in addition to standard corporate income tax. These arise in four different ways.

Firstly, in some cases the Commonwealth Government imposes export duties. The major recent example of this is of course the coal industry. The coal export levy was first introduced for coking coal, but spread to steaming coal in the wake of a stronger market for this second type of coal. More recently the Government has responded to weakness in the coal markets by eliminating the levy for all except certain hard coking coals.

Secondly, state governments impose explicit royalties on mining operations through a variety of regulations that vary from commodity to commodity and from state to state. Thirdly, in the case of coal in particular, two state governments impose substantial implicit royalties through including an excess profit component in rail freights charged for coal transport by the respective state rail monopolies. Finally, in the case of these state rail monopolies, freight rates are higher than they otherwise would be because of inherent inefficiencies in the conduct of these rail operations and because the suburban commuter systems have to be subsidised. This last imposition is difficult to measure, but relevant comparative data concerning other bulk rail freight operations — such as iron ore transport in Western Australia, and rail freight of coal in North America — suggest it is significant, after allowing for technical differences between the respective operations such as the distance hauled, and the number of commodities and customers a given rail network has to serve.

The combined magnitude of these additional charges is substantial. For example looking at the AMIC "Minerals Industry Survey" of 1981, compiled by Coopers & Lybrand, we see that for 117 respondents to the survey, total income tax paid for the year ended June, 1981 was about $540 million. In addition to this the companies paid about $80 million for the Commonwealth coal export duty, and about $200 million for explicit state government royalties, and also mining licence fees etc. In addition, although difficult to estimate, implicit state royalties through excess rail freight profits almost certainly exceeded $100 million, while the imposition due to inherent operational inefficiencies in state rail monopolies was probably of the order of $20 — $40 million.
Together these additional financial impositions amounted to something like three-quarters of corporate income tax paid in respect of the 1980/81 year.

The mining industry has three substantial complaints about this situation. Firstly the magnitude of these extra charges is too high. Secondly, and more importantly, there is in many cases an unnecessary degree of uncertainty in the future level of these charges. Mining companies along with all private companies are accustomed to the vagaries of the market place, but policy settings by government monopolies are inherently more uncertain than most private market variables because the governments have a monopoly over these policy settings, such as taxation, and because the political influences on these policy settings include all kinds of electoral factors outside the industry which is the target of these settings.

Thirdly, and perhaps most important of all, the method of levying these extra government charges is highly regressive and inefficient because in most cases these charges represent a direct and unavoidable addition to unit costs regardless of the profitability of the operations concerned. In competitive mineral markets where prices, over the long term at least, tend to approach marginal costs, the imposition of these charges in Australia leads directly to a smaller share by Australia in world mineral markets. This is particularly the case in the coal industry where, as I have already noted, the supply cost curve tends to be relatively flat and where, therefore, a few dollars per tonne can be critical in deciding whether to build or not build a new mine. Mining companies are not averse to paying some additional charges which reflect the long established legal principle in this country that the ultimate ownership of mineral resources is vested with governments through the Crown. However, it would be much more rational and efficient in terms of encouraging a larger cake for all, if such additional charges were to be based on a share of profits rather than on flat unit revenue impositions.

Turning briefly to the labour situation, the main problem here, in common with many of the problems with governments, is that many workers and their trade unions are largely divorced from, or are unconscious of, the stark realities of competing in the market place — at least until such time as the very survival of a company or its industry is at stake and the workers concerned can finally see that their whole livelihood is at stake. Company managers in Australia, least of all those in the mining industry, can hardly claim to be blameless in bringing about the current poor state of industrial relations in Australia. Nevertheless trade conditions, and also governments, must share a considerable part of the blame for these problems through sustained emphasis for too long on such themes as comparative wage justice, inter-union conflict for market share of the workforce, unrealistic redundancy provisions, etc."

If the comments and opinions of the speakers are well informed, then some readers may question the true worth of resources investments in Australia. Alternatively, readers may feel that the necessary transitions in policy will be accomplished without undue disruption in the worth of their investment holdings. Regardless of recession, change is foreshadowed, and with change, some considerable economic costs or benefits to different sections of the Australian community. Will it occur by 1990 or will Australia's standing decline still further by the year 2000?